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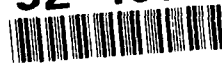
March 1992

INTERNATIONAL PROCUREMENT

NATO Allies' Implementation of Reciprocal Defense Agreements



92-16360



GAO/NSIAD-92-126

National Security and
International Affairs Division

B-247389

March 18, 1992

The Honorable Claiborne Pell
Chairman, Committee on Foreign
Relations
United States Senate

The Honorable Sam Nunn
Chairman, Committee on Armed
Services
United States Senate

The Honorable Dante B. Fascell
Chairman, Committee on Foreign
Affairs
House of Representatives

The Honorable Les Aspin
Chairman, Committee on
Armed Services
House of Representatives

The Honorable Nicholas Mavroules
Chairman, Subcommittee on
Investigations
Committee on Armed Services
House of Representatives

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In response to the requirement set forth in the National Defense Authorization Act for Fiscal Years 1992 and 1993 (P.L. 102-190) and a request from the Chairman, Subcommittee on Investigations, House Armed Services Committee, we reviewed how various North Atlantic Treaty Organization (NATO) countries are implementing their reciprocal defense procurement memorandums of understanding (MOU) with the United States. We visited or obtained information from eight European countries—Belgium, France, Germany, Italy, the Netherlands, Portugal, Spain, and the United Kingdom. In a prior report entitled European Initiatives: Implications for U.S. Defense Trade and Cooperation (GAO/NSIAD-91-167, Apr. 1991), we had raised questions about the use of MOUs to enhance U.S. sales to the NATO allies.

In this report we (1) compare how the United States and the allies view the MOUs and implement certain aspects of the agreements; (2) examine

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whether MOUs provide opportunities for U.S. firms to compete freely and fairly in allied defense markets; (3) examine the extent to which allied governments' tariff practices affect contract selections; (4) review allied contract-award grievance procedures; and (5) assess Department of Defense (DOD) efforts to monitor the MOUs.

Background

The United States has entered into reciprocal defense MOUs with 21 allied and friendly nations, including 13 European NATO members. These agreements, signed between 1975 and 1991, are intended by the United States to enhance military readiness by promoting rationalization, standardization, and interoperability of military equipment. The MOUs seek to promote competitive opportunities for the signatories' defense industries and call for the reduction of certain barriers, such as buy-national laws and tariffs.

When the earlier MOUs were signed, annual U.S. defense exports to the European NATO allies were significantly greater than annual U.S. defense imports from the allies. DOD estimated the trade ratio to be in favor of the United States by about 8 to 1 in the late 1970s. However, this ratio has declined and since 1986 has leveled off to about 2 to 1 in favor of the United States, according to DOD. More data on defense trade between the United States and the European allies from 1983 to 1989 is presented in appendix I.

Results in Brief

The European allies and the United States recognize that the MOUs are primarily national security agreements. However, several European officials also emphasize the trade and economic aspects of the agreements because the United States waives the Buy American Act to implement the MOUs. However, the allies do not have "umbrella" buy-national laws comparable to the Buy American Act, and preferences for European products fall outside the types of barriers addressed in the MOUs.

The MOUs do not ensure fair treatment for either U.S. or European contractors. Even though the United States waives the Buy American Act, it continues to place many restrictions on its offshore defense procurements. The allies said that although they seek to maximize competition, they reserve the right to direct contracts to domestic or other European sources.

Some European countries pay tariffs on U.S. defense imports, and one country acknowledged considering tariffs when evaluating U.S. companies' bids. Despite this practice, U.S. industry, U.S. government, and allied officials do not believe that tariffs are a significant factor in contract selections. Additionally, U.S. contractors rarely appeal European contract awards because this is not a customary business practice in these countries and contractors fear losing future contract opportunities if they protest.

DOD has not adequately followed up on recent MOU-related initiatives intended to promote fair treatment and assist U.S. contractors seeking defense business opportunities in Europe. DOD officials acknowledged that they need to do more in these areas.

MOUs Enable Allies to Compete for DOD Contracts

The MOUs obligate the signatories to evaluate bids without considering the cost of tariffs to the extent consistent with national laws and regulations. The agreements also seek to eliminate, on a reciprocal basis, buy-national laws and tariffs relating to defense procurements, but do not specifically obligate the signatories to do so. DOD meets its MOU obligations primarily by waiving the Buy American Act¹ and import duties on eligible goods purchased with DOD-appropriated funds. By waiving the act for MOU signatories, DOD has permitted European firms to compete with U.S. firms for billions of dollars worth of defense contracts.

While noting the national security aspects of the agreements, officials from seven of the eight countries included in our review also recognized the MOUs' economic and trade aspects. French officials described the MOU primarily as a trade agreement. Representatives from the United Kingdom, Germany, and France—the European allies with the largest defense exports to the United States—noted that the Buy American Act waiver was an important benefit. They said that without the waiver their defense contractors would be unable to compete on an equitable basis with U.S. suppliers for DOD contracts. These officials noted that prior to the MOUs the defense trade balance favored the United States. In their view, the MOUs have helped achieve more balance in defense trade. Netherlands and



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¹The Buy American Act, which dates back to 1933, implements a policy preference for goods produced or manufactured in the United States. As implemented, the act does not prohibit purchases from foreign firms but provides an advantage to domestic producers by adding a cost differential to foreign products during the contract evaluation stage. For example, DOD generally adds a 50-percent evaluation factor to the offered price of foreign end products when the foreign product is competing against a U.S. product.

Spanish officials stated the MOUs may have had some effect in opening the U.S. defense market.

Market Access Is a Contentious Issue

Officials from most of the countries we visited said that despite the MOUs, their contractors have limited access to the U.S. defense market. DOD estimated that no more than 44 percent of the U.S. defense procurement market—about \$56 billion—was open to foreign competition in fiscal year 1990. European officials cited numerous legislative and regulatory restrictions that close segments of DOD procurement from foreign sources. A 1989 DOD report stated that numerous laws prohibit it from procuring items such as certain specialty metals, anchor chains, mooring chains, machine tools, and various weapons and ordnance from foreign sources. DOD is also required to set aside some contracts for small and minority U.S. businesses. Additionally, the United States restricts procurements for national mobilization reasons. None of these types of restrictions are waived by the MOUs.

In September 1991, the United Kingdom Chief of Defense Procurement noted in a letter to the Undersecretary of Defense for Acquisition that U.S. legislation protecting U.S. anchor chain producers could potentially damage the bilateral defense trade relationship. Spanish and Italian officials cited other instances of protectionist U.S. legislation that could damage defense trade relations. A French defense official stated that if the United States reduced restrictions, the French government would be willing to reciprocate.

Benefits for U.S. Contractors Are Difficult to Quantify

A high-level DOD acquisition official told us that MOUs have probably been more advantageous to the European allies than the United States in terms of opening defense markets. A number of U.S. industry officials that we interviewed said that the agreements have had limited value in promoting openness in European defense markets. In 1989, two trade associations representing over 1,700 U.S. firms noted in a letter to DOD that the MOUs' benefits to U.S. industry were minimal. The letter indicated that foreign defense procurement practices were not open and opportunities for U.S. defense suppliers had therefore continued to be limited.

European officials said that their governments do not have "umbrella" buy-national laws comparable to the Buy American Act. As a result, according to British and French officials, highly visible changes to their

defense procurement systems have not been necessary to implement the MOUs.

DOD officials emphasized the national security benefits of the agreements, which enhance alliance-wide security objectives and serve as an underpinning for armaments cooperation. They also said that the MOUs help conserve funds by fostering competition. Nevertheless, DOD officials also acknowledged the trade implications of the MOUs. In their view, the MOUs help keep foreign markets open to U.S. industry by reducing European protectionism. They were unable to quantify, however, the extent to which the MOUs have helped U.S. contractors maintain access to the European defense market.

German and British officials said the MOUs have helped keep their markets open to the United States. British officials stated that the MOU had promoted greater armaments cooperation with the United States. They stated that from 1976 to 1989, the United Kingdom had purchased over \$12 billion in defense goods from the United States.

MOUs Do Not Ensure Access to Defense Markets

MOUs do not guarantee fair treatment for either U.S. or European contractors. Several MOUs state that competitive contracting procedures should normally be used to purchase defense equipment, but industry is primarily responsible for finding business opportunities. Allied officials said they seek to maximize competitive opportunities but reserve the right to limit competition or direct contracts to national or other European sources.

In a February 1991 "white paper," DOD outlined several European government procurement practices that imposed barriers to defense trade. DOD noted that the United Kingdom, France, and Germany all promote national defense industries through either subsidies or sole source contract awards. DOD further stated that the French Ministry of Defense routinely publicizes procurements but tends to select French contractors for serious negotiations.

Political Factors May Influence European Procurement Decisions

Political and economic factors can influence European procurement decisions. For example, in June 1991 the British government selected a domestic firm to produce its new main battle tank. U.S., French, and German firms competed against the British candidate. During the competition, reports circulated in the United Kingdom that

10,000 domestic jobs would be lost if the award went to a foreign firm. The British contractor cited the potential loss of a key sector of the United Kingdom industrial base if the U.S. contractor won. According to a July 1991 document prepared by the U.S. Defense Cooperation in Armaments Office, London, the British candidate was not the first choice recommended by the British Army.

British procurement officials told us that in larger procurements, political considerations must be taken into account by their government. In their view, however, the tank selection was influenced primarily by the need for intraoperability within the British tank fleet. The British tanks' main gun and ordnance, however, are not compatible with those adopted by the United States, France, and Germany.

U.S. Defense Firms' Views on Factors Affecting European Market Access

U.S. industry officials said that several factors are required to successfully compete for defense-related contracts in Europe. These include (1) lessening U.S. government controls on the transfer of technology to European industry; (2) understanding the host country's defense procurement procedures and practices, including offset requirements²; and (3) maintaining a substantial in-country presence, including continuing and personal contact with key defense and industry officials.

U.S. industry officials also noted that successful marketing strategies should include opportunities for European defense firms to participate with U.S. firms. We found that the degree of such participation can be significant. For example, a U.S. firm teamed with a British firm in 1991 to win a prime contract to manage systems integration and other management support activities for the United Kingdom's next generation antisubmarine helicopter. The contract is valued at approximately \$2.6 billion. Over 95 percent of the work, however, will be performed by British and Italian industry. An official from the U.S. firm said that potential political controversy was avoided by structuring the contract with significant European content.

²Offsets are a range of industrial and commercial compensation practices required by foreign governments and firms as conditions for the purchase of military exports. Offsets include technology transfers, licensed production, coproduction, and foreign subcontracting.

MOU Annexes Are Intended to Promote Equal Treatment

DOD added procurement procedures annexes to existing MOUs to (1) promote more openness and accountability in European defense procurement and (2) ensure equal treatment for U.S. contractors. DOD officials responsible for negotiating the MOUs said the annexes would probably benefit smaller U.S. firms that do not have offices or established contacts in Europe. Procurement annexes were signed with France, Italy, and the Netherlands in 1990 and Norway and Germany in 1991. At the time of our review, DOD was negotiating an annex with the United Kingdom. The annexes typically (1) address the publication of bids; (2) require the signatories to have procedures for addressing grievances; (3) provide that upon request, suppliers will be promptly provided pertinent information as to why they were not allowed to participate in a procurement or were not awarded a contract; and (4) call for the discussion of the adverse impacts of offsets on the industrial base of each country.

The annexes obligate the signatories to publish procurement opportunities according to national thresholds in generally available periodicals. U.S. procurement regulations generally require all procurements over \$25,000 to be published in the Commerce Business Daily. Thresholds for France, Italy, and the Netherlands vary but are higher than the U.S. threshold. French officials stated that when competition is sought, procurements over 900,000 francs (approximately \$163,000) must be advertised in a journal similar to the Commerce Business Daily. Italy and the Netherlands have agreed to advertise defense procurements over approximately \$1.3 million, consistent with Independent European Program Group (IEPG) standards.³ DOD officials recognize this disparity but stated that U.S. firms would generally not compete for contracts lower than these European thresholds. They did not provide any specific data to support this position.

Commerce Expressed Concerns About Reciprocal MOUs

As required by the National Defense Authorization Act for 1991 (P.L. 101-510), DOD solicited the Department of Commerce's recommendations on the proposed reciprocal procurement annexes. Commerce said that the MOU annexes should include provisions conforming closely to the Government Procurement Code, which is under the General Agreement on Tariffs and Trade. For specified procurements, the code (1) requires signatories to adopt transparent—open and

³The Independent European Program Group is an intergovernmental organization consisting of the European members of NATO. It was designed to promote European cooperation in research, development, and production of defense equipment; improve transatlantic armaments cooperation; and maintain a healthy European defense industrial base.

predictable—procedures and not to discriminate, (2) guarantees procurement opportunities rather than actual sales, (3) obligates the signatories to provide full information to other signatories on every stage of their procurement process, and (4) establishes formal procedures to enforce signatories' obligations. While the United States and nine European NATO allies are signatories to the code, it does not cover government purchases of military weapons and many other defense articles.

DOD did not accept Commerce's recommendations. DOD noted that such provisions were too cumbersome for defense procurement and would eliminate the flexibility required on such procurements. DOD said that it had captured the basic elements of the code, without as much detail, in the procurement annexes. Commerce officials told us that the annexes would not ensure increased openness in European defense procurement because they lack specificity and are not enforceable.

DOD officials stated that sovereign nations must reserve the right to regulate defense trade for national security reasons. As a result, defense trade should not be subject to specific code requirements, including enforcement procedures.

German, French, Netherlands, and United Kingdom officials said the annexes would have minimal impact on their procurement systems. They maintained that their defense procurement procedures were already open and accessible to U.S. contractors. Some of these officials noted, however, that the annexes are useful because they address DOD's concerns and increase awareness of, and help clarify, existing procedures. Netherlands officials told us, however, that the annex's effectiveness will remain theoretical as long as the United States maintains its protectionist laws and policies.

Allies and U.S. Industry Maintain That Tariffs Are Not an Impediment

As previously noted, MOUs call for the reciprocal waiver of buy-national restrictions, customs, and duties to enable U.S. and European contractors to compete for defense contracts of the other country. Some European nations that have MOUs pay European Community (EC) tariffs on defense

imports from the United States.⁴

In our prior report we noted that Germany, the Netherlands, and Belgium were paying EC tariffs on defense imports from the United States. The United Kingdom paid duties on certain dual-use items, which comprise about 7 percent—by contract value—of all ministry of defense procurements. With the exception of Belgium, officials from these countries maintained that while they pay EC tariffs they do not consider them in bid evaluations. For example, German officials said that their government pays an approximately 3-percent EC tariff on all defense imports from the United States. However, German procurement regulations specifically exclude the cost of the tariff from bid evaluations. Netherlands officials said they pay EC tariffs of up to 6 percent on defense imports from the United States. However, tariffs are waived for the F-16 program.

Belgian officials stated they were not aware of any cases where their evaluation practice caused a U.S. firm's bid to be noncompetitive because other factors, such as quality, cost, and offsets were more important. Officials from all four of the countries that pay tariffs said they were not a determining factor in contract award decisions. In their view, tariffs were a peripheral issue. Numerous representatives of U.S. defense firms in Europe, as well as U.S. embassy officials, stated that tariffs were not a determining factor in contract selection.

European Grievance Procedures Are Rarely Used

European contract grievance procedures, which vary from country to country, are rarely used by either European or U.S. firms. Both host nation and U.S. industry officials stated that formal protests are not considered a customary business practice. As a result, European procedures governing these matters did not appear to be as formal or widely used as U.S. procedures.⁵

⁴EC members have a common external tariff and no internal tariff barriers. The common external tariff, which is imposed on imports from non-EC members, includes duties for defense imports. The duties are paid by the member states to the European Commission in Brussels. However, member states interpret their obligation to pay these defense import duties differently. Some member states maintain they have the right to waive the duties, while others stated they are obligated to pay them.

⁵Various options are available to U.S. and foreign contractors wishing to appeal contract awards in the United States. For example, contractors can file protests with the agency that awarded the contract, the General Services Board of Contract Appeals (for automatic data processing contracts), and the General Accounting Office (GAO). In fiscal year 1990, GAO received over 2,800 protests.

Spanish defense officials stated that they do not maintain formal grievance procedures. According to U.S. embassy and Italian industry officials, Italy's procedures involve civil court appeals and were described as cumbersome. Officials from Belgium, Germany, France, and Portugal described procedures that may include appeals to the defense procurement agency, other governmental organizations, and/or the civil courts. French officials said they normally prefer to settle disputes at the lowest levels possible. British and German officials said that once a contract has been awarded it will not be reversed.

U.S. firms have, in a couple of cases, appealed recent contract decisions. In 1990, a U.S. firm was compensated by the German government for its bid costs after claiming that an award was made unfairly to a German competitor. In the Netherlands, a U.S. company protested a contract decision in favor of a Netherlands firm and is awaiting the outcome of a Ministry of Defense investigation.

U.S. industry officials said they were generally unaware of specific allied grievance procedures. Furthermore, they said they would be reluctant to use such procedures for fear of losing future business.

DOD Has Not Adequately Followed Up on Recent Initiatives

To improve access and ensure equitable treatment for U.S. defense contractors, consistent with the MOU principles, DOD (1) publishes, in conjunction with Commerce, a pamphlet to assist U.S. companies wishing to do business with MOU signatories; (2) participates in an interagency group with the Departments of State and Commerce and the Office of the U.S. Trade Representative to support defense trade opportunities and initiatives; and (3) investigates U.S. defense contractors' complaints of alleged discrimination by European governments. Additionally, Offices of Defense Cooperation in each of the European embassies support, to varying degrees, U.S. contractors' marketing efforts and in some cases identify procurement opportunities.

While these efforts may lead to greater access, DOD has not adequately followed up on other recent initiatives. Although DOD stated that the procurement annexes are an important part of its strategy to better ensure reciprocity in defense trade, including increased contract opportunities for smaller U.S. firms, it has not determined the extent to which the allies are implementing these annexes. Netherlands officials said that DOD had not requested implementation information, while French officials stated that they had provided data pertaining to procurement thresholds. France also

provided DOD with its grievance procedures after we had queried French officials about this matter. In October 1991, DOD had preliminary discussions with the Italian government about offsets at an annual MOU meeting but has not followed up on other procurement annex provisions. DOD officials acknowledged that they had not adequately followed up on annex implementation but said they intended to do so.

DOD plans to address offsets through consultations with all the allies in accordance with a 1990 presidential policy statement on offsets. Consultations were to be conducted in coordination with the Department of State. We noted⁶ in a December 1990 report that DOD had not begun these discussions.⁶ As of January 1992, DOD had still not established a time frame for beginning this process.

DOD Has Taken Limited Action to Encourage Allies to Assist U.S. Contractors

In April 1991, DOD designated a senior-level acquisition official to serve as an ombudsman on behalf of foreign governments that have MOUs with the United States. The ombudsman, whose position was established under the fiscal year 1991 defense authorization act, assists foreign officials to comply with DOD acquisition requirements and investigates complaints of unfair treatment. In April 1991, DOD encouraged all the MOU signatories to designate a similar official. The DOD ombudsman acknowledged that he had made limited efforts to follow up on these requests. As of December 1991, only the Netherlands had officially designated an ombudsman among the European NATO allies. The United Kingdom did not officially designate an ombudsman but identified two procurement officials as points of contact to provide assistance. German, Belgian, Spanish, and Portuguese officials said that U.S. contractors do not need an ombudsman because they already know whom to contact if they require assistance.

Some U.S. defense industry representatives questioned the need for ombudsmen for large U.S. defense firms but stated that smaller U.S. firms seeking defense business in Europe might benefit from an ombudsman. With the reductions in U.S. military spending, more small and mid-size U.S. firms may be interested in competing in these foreign markets for the first time.

⁶Military Exports: Implementation of Recent Offset Legislation (GAO/NSIAD-91-13, Dec. 1990).

Recommendations

We recommend that the Secretary of Defense take the following actions:

- Request that the foreign signatories of procurement annexes provide specific information demonstrating how they are implementing all the provisions of these annexes. Furthermore, in future annexes, mutually agreed upon language should be included that would enable both governments to periodically review progress made in implementing the provisions of the annexes.
- Strongly encourage MOU signatories to promote greater reciprocal defense market access by designating ombudsmen to assist U.S. contractors. These ombudsmen should provide services similar to those provided by the DOD ombudsman.

As requested, we did not obtain written agency comments on this report. However, we discussed its contents with DOD and Commerce officials as well as foreign government officials. We incorporated their comments where appropriate.

We plan to send copies of this report to other interested congressional committees; the Secretaries of Defense, Commerce and State; and the U.S. Trade Representative. We will also make copies available to others upon request.

This report was prepared under the direction of Joseph E. Kelley, Director, Security and International Relations Issues. Please contact him at (202) 275-4128 if you or your staff have any questions concerning this report. Our scope and methodology are contained in appendix II. Other major contributors to the report are listed in appendix III.



Frank C. Conahan
Assistant Comptroller General

Status of Defense Trade Between the United States and the European Allies

In our prior report, we stated that the U.S. defense trade advantage with 13 of the European NATO countries, while still favorable to the United States, had significantly declined since the reciprocal procurement MOUs were initially negotiated. This decline was most marked between fiscal years 1983 and 1987—the period for which the Department of Defense (DOD) had collected adequate data and had updated the original published figures. Although we questioned whether the ratio was as high as DOD estimated between fiscal years 1983 to 1986, our alternative estimate also revealed a decline in this advantage.

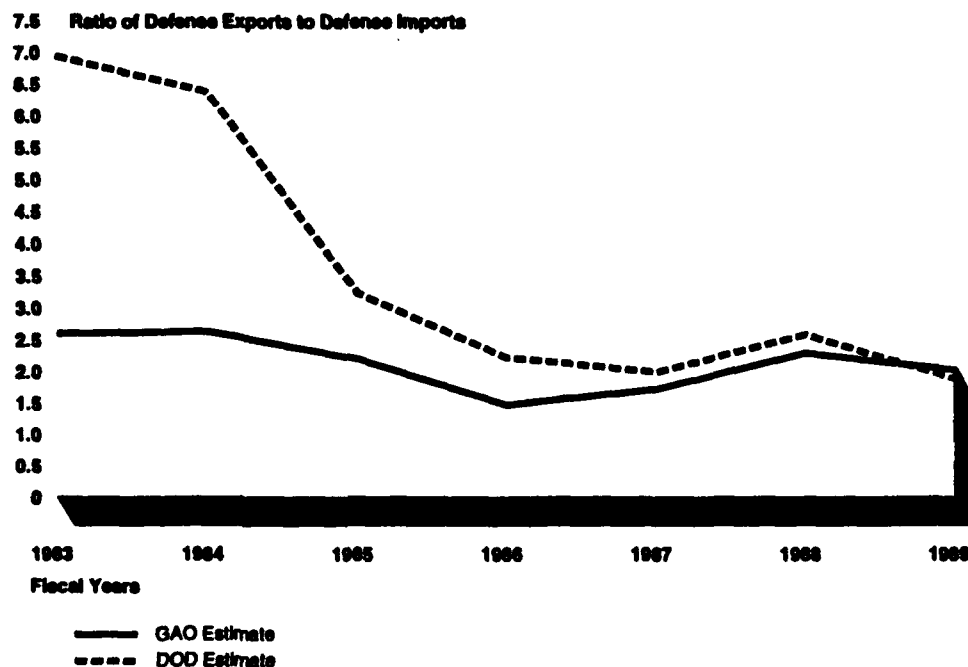
For this report, we updated our figures to include fiscal years 1988 and 1989 and compared them to DOD's estimates. Both estimates show that the U.S. advantage increased somewhat in fiscal year 1988, although this improvement is due more to a decrease in U.S. purchases from the allies rather than an increase in U.S. sales. The U.S. trade advantage declined in fiscal year 1989. Our analysis shows that the U.S. defense trade surplus increased between 1987 and 1989 in total dollar terms. DOD's analysis shows that the surplus increased in fiscal year 1988 but decreased in fiscal year 1989.¹

DOD's estimates for fiscal year 1988 show that the U.S. advantage increased to about 2.6 to 1 in fiscal year 1988 before declining to 1.9 to 1 in fiscal year 1989. We estimate that the defense trade ratio rose to about 2.3 to 1 in fiscal year 1988 before falling to 2 to 1 in fiscal year 1989. (See fig. I.1 for DOD's and our estimates for fiscal years 1983-89.)

¹According to DOD, some of the data for fiscal year 1989 has not been finalized.

Appendix I
Status of Defense Trade Between the United
States and the European Allies

**Figure I.1: U.S. and European NATO
Countries' Defense Trade/Procurement
Ratios**



Notes:

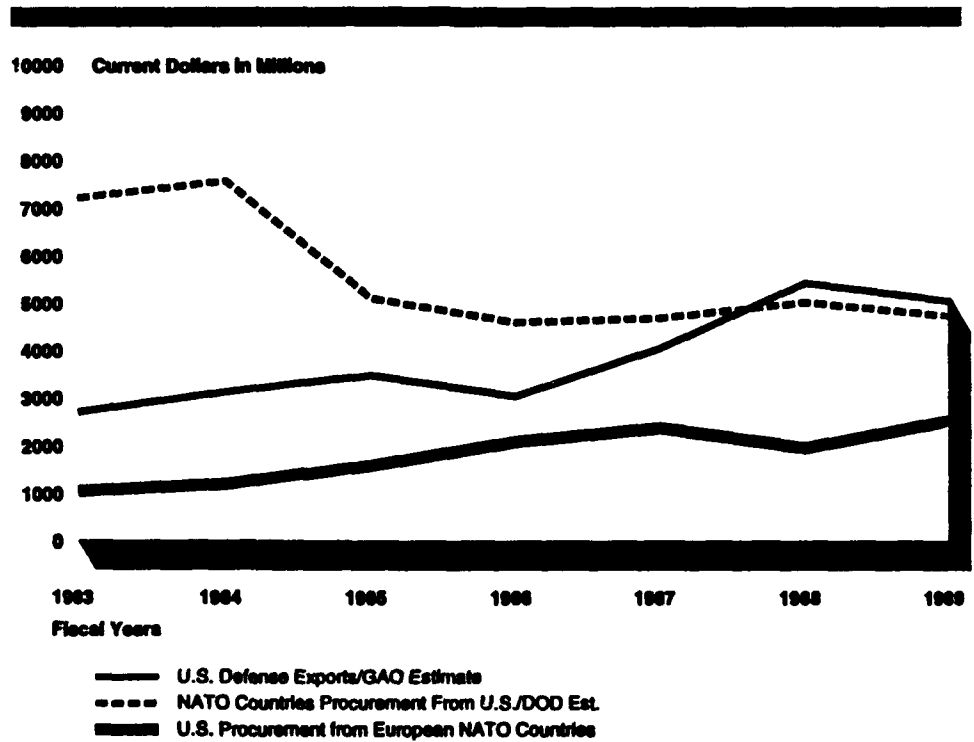
1. DOD's estimate is based in part on annual FMS agreement data, which tends to exceed actual foreign military sales delivery data used in GAO's estimate. As a result, there is a significant disparity between DOD's estimate and GAO's estimate, particularly between fiscal years 1983-86.

2. A further explanation of the defense trade relationship between the United States and European NATO countries is discussed in our prior report European Initiatives: Implications for U.S. Defense Trade and Cooperation (GAO/NSIAD-91-167, Apr. 1991).

In figure I.2, we compare DOD's measurement of the defense procurement balance to our measurement of the defense trade balance in current dollars. DOD's estimates indicate that the European allies procured over \$6 billion more from the United States than the United States procured from them in fiscal year 1983. This trade surplus decreased to \$2.5 billion in fiscal year 1986 and to \$2.3 billion in fiscal year 1987. According to DOD, the surplus increased to over \$3.1 billion in fiscal year 1988 but then declined to \$2.2 billion in fiscal year 1989. Our estimate shows that the U.S. defense trade surplus declined from over \$1.6 billion in fiscal year 1983 to less than \$1 billion in fiscal year 1986. The surplus has increased from about \$1.7 billion in fiscal year 1987 to over \$2.5 billion in fiscal year 1989. (See fig. I.2 for DOD's and our estimates for fiscal years 1983-89.)

Appendix I
Status of Defense Trade Between the United
States and the European Allies

Figure I.2: U.S. and European NATO
Countries' Defense Trade/Procurement
Dollar Flows



Notes:

1. European NATO countries' procurements reflect defense ministries' purchases.
2. A further explanation of the defense trade relationship between the United States and European NATO countries is discussed in our prior report, European Initiatives: Implications for U.S. Defense Trade and Cooperation.

Figure I.2 also shows that annual U.S. procurements from the 13 European NATO countries increased from about \$1 billion to approximately \$2.4 billion between fiscal years 1983 and 1987. This figure declined to less than \$2 billion in fiscal year 1988 but rose to a new high of \$2.5 billion in fiscal year 1989.

Scope and Methodology

To review how the NATO allies are implementing their reciprocal MOUs with the United States we visited seven European countries—Belgium, France, Germany, Italy, the Netherlands, Spain, and the United Kingdom. We also met with Portuguese representatives during our visit to Belgium. We selected these countries to obtain a broad range of views about the MOUs and defense trade issues from both highly industrialized countries and countries with developing defense industries. We met with ministry of defense, economic affairs, or foreign affairs officials and provided questions to each government prior to our visit. We tried to ensure that cognizant European officials were present when discussing technical matters such as customs and tariffs.

We performed segments of our work at the U.S. embassy in each of the countries visited. We met primarily with officials from each embassy's Office of Defense Cooperation, who are generally responsible for monitoring MOU and defense trade-related matters. We also reviewed files and obtained pertinent documents from each office.

We discussed the European defense market, the value of MOUs, and defense trade in general with U.S. defense industry representatives located in Belgium, France, Germany, the Netherlands, Spain, and the United Kingdom. We also met with U.S. industry representatives in the United States and had discussions with representatives of defense industry associations in Washington, D.C.

Some U.S. industry representatives declined to meet with us because (1) they believed the issues were too sensitive, (2) they had recently discussed these matters with other U.S. government officials, or (3) they believed such discussions would not lead to any improvements in the conduct of defense trade with Europe.

We reviewed matters related to the U.S. government's implementation and oversight of the MOUs, as well as other defense trade issues, through discussions and documentation obtained at the Departments of Defense, State, and Commerce and the Office of the U.S. Trade Representative. We assessed the U.S. government's implementation of the MOUs by checking program files and interviewing DOD officials. We examined the federal acquisition regulations as well as DOD documentation and regulations related to MOU implementation. We updated the defense trade analysis included in our prior report to include fiscal years 1988 and 1989. We reviewed the data that DOD uses to measure the defense procurement balance between the United States and the 13 European NATO allies and

examined its methodology in calculating the balances. We updated our alternative defense trade balance assessment using the same data sources and methodology as in our prior report. That report fully discussed the methodologies used in this analysis and explained the limitations of the data.

Since fiscal year 1988, DOD has used data certain European countries provided on their purchases of U.S. defense items in place of U.S. export data provided by DOD and the Department of State. For example, DOD used procurement data provided by Germany, the Netherlands, Norway and the United Kingdom to assess the value of U.S. defense exports to those countries for fiscal year 1989. According to DOD, this method provides a more accurate reflection of those countries' yearly defense procurements from the United States. Unless major discrepancies exist between the allies' data and DOD's data, DOD accepts their numbers at face value. We did not verify the accuracy of the data.

We did our work between July 1991 and January 1992 in accordance with generally accepted government auditing standards.

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